



Washington State Auditor's Office

2003 Higher Education System Report



Washington
State Auditor
Brian Sonntag

Washington State Auditor's Office
Mission Statement

The State Auditor's Office independently serves the citizens of Washington by promoting accountability, fiscal integrity and openness in state and local government. Working with these governments, we strive to ensure the proper use of public resources.

**STATE AUDITOR'S OFFICE
STATE OF WASHINGTON HIGHER EDUCATION ACCOUNTABILITY REPORT
FISCAL YEAR 2003**

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The State Auditor's Office is pleased to present this report on our audit of the state's higher education system. In it, we are presenting the results of our audits for 2003.

This report reflects our continuing efforts to look at issues and systems on a statewide basis in an effort to give a comprehensive view of the results of our audits.

I encourage you to contact our Office with any questions or comments you may have on this report.

Sincerely,

BRIAN SONNTAG, CGFM
STATE AUDITOR

About Washington's Public Higher Education System

Washington's public higher education system consists of 28 community colleges, five technical colleges and Seattle Vocational Institute, two public research universities with five branch campuses and one evening degree program and four comprehensive institutions with nine off-campus centers. The system has 58 off-campus centers operated by the community and technical colleges. The system also includes cooperative extension centers, learning centers, on-line learning resources and other collaborative opportunities through the K-20 Educational Telecommunications Network.

Public higher education received approximately \$2.84 billion of the 2001-03 State General Fund operating budget and more than \$1 billion in the Capital Budget. The General Fund provides the institutions of higher education from 16 percent (at the University of Washington) up to 60 percent (at a few -community and technical colleges) of their funding. In addition, operating fees (tuition) provide approximately \$619 million to the research and regional institutions and more than \$307 million to the community and technical colleges.

Approximately 287,000 full- and part-time students attend public colleges and universities, with approximately 96,000 enrolled at the four-year institutions and 191,000 enrolled at the two-year institutions. Each institution has a board of regents or trustees appointed by the governor

Background

Community and Technical Colleges

The community and technical college system is generally controlled and supervised by the State Board for Community and Technical Colleges, whose duties include preparation of a single budget for the system, establishment of guidelines for disbursement of funds and other financial procedures necessary to supplement general requirements set forth by the Office of Financial Management (OFM), the ability to sell, exchange, or convey any or all interest in any community college real and personal property, and the establishment of minimum standards for community college admission and enrollment policies, curriculum content, and instructional and key administrative personnel qualifications.

The community and technical colleges range in size from very small to the third largest higher education institution in the state. Many of the controls in these colleges are moving to decentralized locations, which increases audit risk depending upon the amount of monitoring performed by the institution.

State law regarding higher education is contained in RCW 28B. Each community and technical college also has adopted rules governing operations.

Four-Year Colleges and Universities

Washington's four-year universities/colleges were created by state law. Each institution has adopted rules governing operations and is subject to certain federal regulations regarding grant expenditures.

These institutions range in complexity from fairly simple and small in size to very complex. Operations may include instruction, research, police, broadcasting, printing and publications, stores, patents and licensing agreements, facilities construction and maintenance and various operations that provide goods and services for a fee to students and the general public (housing and food services, hospitals, museums, libraries, intercollegiate athletics, parking, creamery, motor pools, laundries, bookstores, etc.). Many of the controls in these institutions are decentralized.

In addition, colleges and universities have established nonprofit organizations (foundations) that engage in fundraising on their behalf. Their activities are governed in part by an Attorney General's Office opinion issued in 1993.

Higher Education Coordinating Board

The mission of the Higher Education Coordinating Board is to provide and recommend to the Legislature and the Governor objective and reliable policies and plans for higher education, and to administer a statewide comprehensive financial aid program. The Board works with public postsecondary institutions in the state and other parts of the higher education system. The goal of the Board is to foster a coordinated system of postsecondary education that is efficient in the use of resources, of high quality, responsive to changing needs, accountable for its activities, and open and available to qualified persons regardless of race, sex, ethnic origin or socioeconomic status.

State Board for Community and Technical Colleges

The State Board for Community and Technical Colleges was created to oversee the community and technical colleges in the state of Washington. The Board has administrative responsibility over the operating and capital budgets for the colleges and allocates General Fund appropriations and some federal and state grant awards. The State Board also works with the colleges on policy issues, curriculum content, degree requirements and admissions policies.

Center for Information Services

The community and technical colleges and the Washington State Board for Community and Technical Colleges formed the Center for Information Services. CIS provides information technology leadership and services to community and technical colleges. A wide area network connects all the administrative mini-computers. CIS develops or acquires software products and helps colleges use these products. It also works with college staff to establish the requirements, service levels, and required resources for information and instructional technologies.

In addition, CIS provides support for community and technical colleges' administrative functions. CIS contracts for technology goods and services for consortium members.

Our Audit Approach

State Auditor's Office Audits

The Washington State Auditor's Office regularly audits approximately 40 state colleges, universities and other agencies related to higher education.

In fiscal year 2003, we audited these institutions:

Four-year colleges and universities

- Central Washington University
- Eastern Washington University
- The Evergreen State College
- University of Washington
- Washington State University
- Western Washington University

Two-year community and technical colleges

- Bates Technical College
- Bellevue Community College
- Big Bend Community College
- Cascadia Community College
- Clark College
- Community Colleges of Spokane
- Everett Community College
- Green River Community College
- Highline Community College
- Lake Washington Technical College
- Olympic College
- Seattle Community Colleges
- Skagit Valley College
- South Puget Sound Community College
- State School for the Deaf
- Tacoma Community College
- Walla Walla Community College
- Whatcom Community College

Other Higher Education Agencies

- Center for Information Services
- Higher Education Coordinating Board
- State Board for Community and Technical Colleges

The scope of our audits is twofold. First, financial records are audited to ensure public funds are accounted for and controls are in place to protect public resources from misappropriation, loss or misuse. Second, we audit to ensure that agencies adhere to laws and regulations relating to financial matters.

The two-year community and technical colleges submit their financial information to the State Board for Community and Technical Colleges where the information is combined. We examine the large consolidated account balances as part of our audit of the state's financial statements. In providing our opinion, we limit our audit scope to those agencies that have large account balances.

At the four-year universities, we may audit financial statements on a separate contract. These audits include The Evergreen State College, Washington State University, Eastern Washington

University, and Central Washington University. Both Western Washington University and the University of Washington's financial statements are audited by a private certified public accounting firm.

However, all higher education agencies' financial information is included in the State of Washington's Basic Financial Statements and is audited by the Auditor's Office at the state level as described below.

For higher education agencies, the Office performs audits on:

- Areas that pose the highest risk for the misappropriation, misuse or loss of public funds or for noncompliance with state laws and regulations. This report includes the results of such audits.
- The State of Washington's Basic Financial Statements. The most recent Comprehensive Annual Financial Report, which includes these statements, was issued by OFM in December 2003 and is available at <http://www.ofm.wa.gov/cafr/2003>.
- More than \$10 billion in federal funds received by the state. The current State of Washington Single Audit Report was issued by OFM at the end of March 2004 and is available at <http://www.sao.wa.gov/Reports/SingleAudit>.
- Local funds kept by agencies that are not in the care or custody of the Office of State Treasurer. Our latest Local Funds Report was issued in December 2003 and is available at <http://www.sao.wa.gov/reports/LocalFunds>.

We also have responsibilities in two other areas:

- Investigations of whistleblower assertions filed by state employees.
- Investigations of potential frauds found during our audits or reported to us by agencies.

High Risk/Legal Compliance Audit

The Office has many competing responsibilities when conducting audits. Our high-risk approach helps to ensure our efforts are properly balanced in order to fulfill these responsibilities. We look at areas that are the most important to the citizens of Washington, our audit clients, the Legislature, and other policymakers.

Key components of our audits are the recommendations we make on how agencies can best safeguard public assets. This can include everything from improved cash-handling procedures to tagging inventory to prevent loss.

We use many techniques to detect misappropriation or misuse of public assets and violations of state laws. Some of those are described below. However, none would be effective without the strong communication skills of our auditors and a solid understanding of the financial processes of each agency we audit.

- Computer-assisted auditing techniques help us assess risk and accountability. Once we download an audit client's financial transactions, we have software applications that can help us find transactions that are most likely to be fraudulent or out of compliance with laws and regulations. These techniques often help us audit expenditures, but they can be used for any type of financial transaction.
- We use analytical procedures to identify account balances that differ from an informed expectation. We often use these procedures to audit revenue streams, looking for activity that could point to a loss or misuse of public assets. These techniques tend to be very efficient and provide strong indicators that additional work may be needed to determine whether loss or misappropriation has occurred.
- We perform surprise cash counts, which are a powerful tool for assessing the effectiveness of controls over money collected at a given location and for finding indications that loss or misappropriation may have occurred.
- We audit certain computer applications looking for security over access and other safeguards. These audits are of enormous value in pointing out conditions that could allow misappropriation or loss to occur without detection by management or conditions that could allow destruction of data. Recommendations from these audits have helped many higher education agencies tighten controls over access to computer systems. These audits also have helped our auditors identify areas in which assets are most at risk.

We audit several areas on a statewide basis each year. Each team that audits higher education agencies uses a consistent approach when looking at areas we believe present a statewide risk of error or misuse or of noncompliance with state laws and regulations. At each agency, we also audit other areas we believe to be high risk. The results of these audits of statewide and agency-specific risks are included in this report.

Comprehensive Annual Financial Report (CAFR)

The State Auditor's Office performs an annual audit of the statewide combined financial statements as required by state law (RCW 43.09.310). These financial statements are included in the Comprehensive Annual Financial Report (CAFR) prepared by, and available from, OFM. This report is designed to present the financial position and the results of operations of the state of Washington. OFM prepared the first CAFR in 1982 and released the fiscal year 2003 report in December. Our Office has audited this report since its inception and has issued unqualified opinions every year since 1987. An unqualified opinion means that the financial statements are fairly stated.

The CAFR reflects the financial activities of all funds, organizations, institutions, agencies (including higher education), departments and offices that are part of the state's financial operations. For the fiscal year ended June 30, 2003, total state revenues and expenditures/expenses were approximately \$35 billion each.

For the last 16 years, the state has received a Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association. This award recognizes

conformance with the highest standards for preparation of state and local government financial reports.

Our audit of the financial statements is conducted in accordance with governmental auditing standards generally accepted in the United States of America, which require us to plan and perform audits to obtain reasonable assurance about whether financial statements are free of significant misstatement. An audit includes examining evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluation of the overall financial statement presentation.

The State Auditor's Office has achieved a significant reduction in audit costs in recent years by adopting a risk-based approach to our audits. Evidence obtained from high-risk audits of state and higher education agencies, which are designed to detect misappropriation, misuse or loss, also is used to support our opinion on financial statements. By leveraging the results of the high-risk work, we perform only the level of review needed to give an opinion on the financial statements. This approach allows us to complete the audit in the most efficient manner possible.

State of Washington Single Audit

The State Auditor's Office audits federal grant expenditures for the state of Washington. That audit is performed in accordance with U.S. Office of Management and Budget Circular A-133 and is referred to as the State of Washington Single Audit. The Auditor's Office has been performing this single audit since 1987. Prior to that time, federal grants were audited as a part of each agency's individual audit. Rather than perform a single audit at each agency, we currently audit the state as a whole, and publish the results in a separate statewide single audit report.

Fraud Program

In fiscal year 2003, the amount of fraud reported to or detected by us in the higher education arena was \$121,002 (15 cases).

Details on these cases may be found at:

<http://www.sao.wa.gov/Reports/FraudReports/FraudPage.asp>

Whistleblower Program

The State Employee Whistleblower Protection Program, administered by our Office, provides state employees with a safe and confidential means to report those actions that can impair the integrity of public government and undermine the public's confidence.

The law authorizes our Office to investigate and report on assertions of improper governmental action that result from violations of federal or state law or rule; a gross waste of public funds; or actions which are of substantial and specific danger to public health or safety. The law also provides remedies to state employees who believe that workplace reprisal or retaliatory action has occurred as a result of having filed, or provided information in connection with, a report of

improper governmental action that results in a whistleblower investigation. The Human Rights Commission is responsible for handling retaliation issues.

During calendar year 2003, the Whistleblower Program investigated 20 assertions regarding higher education and substantiated 30 percent of them.

Financial Analysis Program

Our Financial Analysis Program assists audit teams in performing computer-assisted audit techniques by allowing the auditors to access the college's financial data electronically. Some of the specific tests included are:

- Duplicate payments.
- Payments to "pseudo vendor numbers" (vendor numbers that should only be used for one-time payments).
- Timeliness of payments.
- Gross profit analysis.
- Selection of vendors that may be under contract and subject to bid law requirements.
- Credit card activity.
- Travel activity.
- Duplicate bank accounts.
- Duplicate vendor and employee addresses.
- Employees as vendors.
- Vendor tax information number matches employee identification number.
- Employee name matches vendor name.

Schedule of Findings

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Agency Findings

Safeguarding of Assets

03-01 The Evergreen State College is not in compliance with state law or policies.

Background

The 2001 and 2002 audits of The Evergreen State College identified several concerns regarding College policies on financial activities there were not being followed, or in some cases, areas in which policies had not been adopted. Although the College has taken some action to address the issues, this continues to be an area of concern.

Description of Condition

The College did not adhere to state law, its own policies and those prescribed by the Office of Financial Management (OFM) in the following areas:

Excessive travel expenditures

Our review identified College personnel were renting cars at a higher rate and class than allowed by the state contract. The contract currently allows for rentals of intermediate size vehicles, unless one is unavailable, in which case a higher class of car is allowed if at no additional charge. We found that the College had incurred charges for vehicles of a higher class and a higher rate with no explanation provided as to why. Our review determined the College paid for approximately 20 percent of its rental car expenses at a rate that was higher than authorized.

Unaccounted for property and equipment

We noted the College was not following policies and procedures regarding accountability over small and attractive assets, including reporting suspected losses to the appropriate state agencies. Per OFM policies and state law, all known or suspected losses of public assets are to be reported to the State Auditor's Office. Our review noted:

- In the Media Center, items such as electronic audio/visual equipment that are loaned to students and not returned are placed on a list of suspected missing/stolen items for a period of two years before College management is notified of the loss.
- The appropriate state agencies including the State Auditor's Office were not notified of the items missing or stolen from the Media Center. In addition, the College identified two items as stolen and failed to notify the State Auditor's Office. Altogether these items totaled more than \$6,000.

Unauthorized cash receipting locations

The Reservation-based Learning Program sold textbooks to students enrolled at tribal-based campuses. Textbook fees were collected from students by program staff. Additionally, staff in

the Media Center collected fees for various items, including graduation videotapes. College management had not authorized the collection of money at either of these locations. Business department management was unaware of this receipting activity.

Noncompliance with College depositing policies

The two departments mentioned above also were not following the College's procedures for depositing funds. Funds collected by the Reservation-based Learning Program were not deposited for several months, resulting in many of the checks received becoming stale-dated, preventing the College from depositing them. Similarly, funds collected in the Media Center were also held for a few months. College policy requires that "collections of more than \$500 must be deposited to the Cashier's Office within 24 hours, and amounts less than \$500 must be deposited no less than weekly..."

Purchasing policies were not followed

At the Reservation-based Learning Program, staff circumvented the College's purchasing procedures by ordering textbooks without going through the College bookstore.

Cause of Condition

The College does not have a process in place to ensure College employees are following established policies and procedures.

Effect of Condition

By not following state law and established policies and procedures in its financial activities, the College cannot ensure the proper use and safeguarding of public resources and that it deposits all funds paid to it.

Recommendations

We recommend the College establish monitoring procedures to ensure employees comply with state law, OFM and College policies.

We further recommend College officials ensure all staff are provided with and understand College policies and procedures.

College's Response

Excessive travel expenditures

We agree that cars were rented at higher rates than allowed under the state contract without documentation. The most frequent instances of vehicle upgrades were in Admissions. The reason for some of the upgrades is to provide safe travel for staff traveling over the mountain passes to Eastern Washington during fall and winter months.

The College is in the process of revising its travel policy. The current travel policy is silent on allowable rental car rates and sizes. There is no direct reference to the state contract provisions. The revised policy will include specific information concerning rental cars including a link to the state contract and outline the process for any exceptions. The travel office will check each rental car invoice and assure compliance, so that no unapproved or unexplained upgrades occur.

Unaccounted for property and equipment

We agree that a few items could not be immediately located. The Media Loan Center loans large quantities of certain equipment and items to students, staff and faculty. Sometimes items are misplaced or returned late. Since the vast majority of missing loaned items is located at some point in time, the Media Loan Center has created a Missing Items List to keep track of misplaced items. The list is updated daily and contains all medial loan center items, not just state tagged equipment and small and attractive items.

The Center conducts an annual internal physical inventory and items that cannot be found during the inventory are reported to the inventory coordinator. The inventory coordinator does not remove the items until the College inventory is conducted every other year.

Going forward, the Media Loan Center will provide a list of missing equipment and small and attractive items to the inventory coordinator monthly. The inventory coordinator will create a report for the director of business services and a copy will be forwarded to the SAO. Missing items will remain on the College inventory until the physical inventory has been conducted and the items remain missing.

To assure that management is informed of all stolen items, the process of reporting missing items was discussed with police services and business services. A campus wide memo will be sent to educate all employees of the existing process and procedures.

One of the missing items mentioned in the findings report is a mini-disc player. It has been determined that the item was not functioning, could not be repaired and had been used for parts, without reporting it to the inventory coordinator. Business Services re-emphasized the proper procedure with the department.

Unauthorized cash receipting locations

We agree. Cash was collected in two areas without authorization from management. Business services met with the department managers and provided copies of the College's cash handling policies. It was emphasized that staff needs to be made aware of the policy and all questions will be referred to business services. A campus wide memorandum will be distributed to remind all employees of the existing cash handling policy. It was also communicated that non-adherence to the policy will not be tolerated.

The cashier's office was instructed to report all violations of the cash handling policy to the director of business services for follow-up and resolution.

Noncompliance with College depositing policies

We agree. See above (unauthorized cash receipting)

Purchasing policies were not followed

We agree. The program that purchased the textbooks was unaware of College policies. The academic division will educate and train all staff on purchasing and cash handling policies. Business services and the purchasing department will monitor College purchases in the academic division closely. Any further occurrence of non-compliance with policies will be brought to the Provost's attention.

Auditor's Remarks

We thank the College for its response. We will review these procedures during the next audit.

Applicable Laws and Regulations

RCW 43.09.185

All entities are to report to SAO known or suspected losses or instances of non-compliance.

SAAM 20.30.10 and 20

20.30.10 "...Comply with RCW 43.09.185 and report losses to the Office of State Auditor (SAO). Comply with RCW 43.09.330 and include the SAO and the Office of the Attorney General in any loss settlement."

20.30.20 "...Report the suspected loss to SAO...if no agreement exists, immediately notify SAO of the suspected loss."

RCW 43.03.050 states:

1) The director of financial management shall prescribe reasonable allowances to cover reasonable and necessary subsistence and lodging expenses for elective and appointive officials and state employees while engaged on official business away from their designated posts of duty. The director of financial management may prescribe and regulate the allowances provided in lieu of subsistence and lodging expenses and may prescribe the conditions under which reimbursement for subsistence and lodging may be allowed.

SAAM 10.50.35a Restrictions and requirements on rental motor vehicle use.

"Rent motor vehicles from rental firms approved by the Department of General Administration (GA), Office of State Procurement (OSP) using a motor vehicle rental card or state rate code, in places where rental firms accept them."

State Contract with Budget Rent-A-Car [Contract #04498]

The contract states, in part: "...Users are reminded to...confirm an intermediate size vehicle when making reservations. For the purpose of size classifications, "intermediate" shall be defined as a mid-sized four-door sedan automobile capable of comfortably transporting four adult passengers and four pieces of luggage. If this size classification is not available at the time of reservation or at the time of vehicle pickup, the traveler will be so advised and offered an upgrade at no additional cost..."

TESC Policy and Procedure Handbook, Section VI D-8 states, in part:

"...All travel by Evergreen personnel is subject to state law and regulations and to the provisions set forth below. The College will reimburse expenses for travel only as provided in those laws and regulations..."

RCW 43.03.060(2) states:

The director of financial management may prescribe and regulate the specific mileage rate or other allowance for the use of privately-owned vehicles or common carriers on official business and the conditions under which reimbursement of transportation costs may be allowed. The reimbursement or other payment for transportation expenses of any employee or appointive official of the state shall be based on the method deemed most advantageous or economical to the state.

TESC Cash Handling Policy states, in part:

"The Controller's Office must authorize all cash collection points."

"Collections of more than \$500.00 must be deposited to the Cashier's Office within 24 hours, and amounts less than \$500.00 must be deposited no less than weekly."

"All funds must be deposited intact, and not intermingled or substituted with other funds."

03-02 Whatcom Community College does not have adequate internal controls and monitoring over contracts and revenue collection.

Description of Condition

We noted inadequate controls and monitoring over contracts and receipt of revenues for the following areas:

- **Athletic events:** The College distributes free programs at basketball games. The programs contain advertisements for local businesses from which the College receives certain services. The College does not have contracts with the businesses formalizing these relationships.
- **Pavilion signage:** The former Athletic Director made verbal agreements with local businesses allowing them to display advertising at the Pavilion at no charge, resulting in a gift of public funds. Revenue lost by the College from this source is estimated at \$10,800 over a period of three years.
- **Facility rentals:** The College charges a fee to rent its facilities to outside parties. We noted several instances in which vendors had not been billed, resulting in \$4,100 in revenue that is at least 90 days past due. In addition, rental fees are not always charged according to the current fee schedule.
- **Food services:** The College contracts with an outside party for food services and is paid a commission based on net sales. The College is relying on the contractor to provide a statement of net sales. The contract requires the vendor to provide register receipts to verify sales. However, this is not occurring.

Cause of Condition

The College's administrative staff was not aware of these conditions and relied on department staff to monitor contracts and track revenues owed to the College.

Effect of Condition

Insufficient controls and monitoring, including a lack of contracts, led to gifts of public funds and to the College not receiving all funds due to it. Additionally, poor internal controls increase the risk of misappropriation or loss of public funds.

Recommendation

We recommend the College:

- Establish and follow sufficient controls to ensure accountability for all public funds.
- Establish formal contracts or agreements with vendors.
- Avoid making gifts of public funds.

College's Response

Of the areas tested for controls and monitoring of the collection of college revenues, four were found to be inadequate. College staff had already identified two of these areas for review prior to the audit. The College is eager to investigate these issues and find appropriate solutions for them.

- ***Athletic Events:*** *Local businesses are mentioned in the WCC basketball programs in appreciation of the contributions they have agreed to donate to the program. The value of these contributions consistently outweighs that of the promotion realized from the publication. These agreements have typically been verbal and casual. Preparing written agreements will formalize this relationship and document expectations.*
- ***Pavilion Signage:*** *The College recognizes the billing/collecting process in this area has failed to keep current. In some cases the promotional signs were simply not removed after the paid period. In other cases, the signs are in exchange for in-kind services from the local business. In these cases, the College must keep current, written agreements with the business.*
- ***Facility Rentals:*** *A formal process must be developed and implemented for the fair and consistent billing of facilities rental contracts. This should include a fee schedule that is based on reasonable value and can accommodate the diverse spaces WCC may rent. The process should also formalize the billing and aging of accounts in a manner that can be financially audited.*
- ***Food Services:*** *The College agrees that the amount of commission due from the vendor must be documented with appropriate proof of cash receipts. Alternatively, an amended contract may be employed that would compensate the college based on something other than the percent of sales.*

It is important to clarify that the college has many revenue sources and that the four areas identified in the audit represent less than half of one percent of all college revenues. Formal management processes have not been developed as the areas in question are relatively new. However, with continued growth, the revenues generated have not become significant and more formal procedures are in order.

The College agrees that a lack of internal controls may increase the risk of misappropriation or loss of public funds. However, many of the above issues do not represent a gift of public funds, but rather, a reciprocation of an in-kind contribution that was simply not documented.

Auditor's Remarks

We appreciate the steps the College is taking to resolve this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

The Office of Financial Management (OFM) *State Administrative and Accounting Manual* (SAAM), Section 20.20.70 describes control activities to help manage risk of loss of funds:

- **Physical controls** - Equipment, inventories, securities, cash and other assets should be secured physically, and periodically counted and compared with amounts shown on control records.
- **Segregation of duties** - Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions. For example, responsibilities for authorizing transactions, recording them, and handling the related assets should be separated.
- **Performance indicators** - Certain operating results can be anticipated. By investigating unexpected results or unusual trends, circumstances that jeopardize the achievement of objectives can be identified.

Section 85.54.10.b of the SAAM manual states in part:

- Agencies are to promptly record receivables when the asset or revenue recognition criteria have been met or the underlying accounting event has occurred and the amount is determinable.

RCW 43.88.160(1) states in part:

- "The governor, through the director of financial management, shall devise and supervise a modern and complete accounting system for each agency to the end that all revenues, expenditures, receipts, disbursements, resources, and obligations of the state shall be properly accounted for...The director of financial management shall adopt and periodically update an accounting procedures manual. Any agency maintaining its own accounting and reporting system shall comply with the updated accounting procedures manual and the rules of the director adopted under this chapter...."

The Washington State Constitution, Article VIII, Section 7 states in part:

- No . . . county shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company, or corporation, except for the necessary support of the poor and infirm

03-03 Whatcom Community College does not have adequate internal controls and monitoring over bookstore inventory.

Description of Condition

The Bookstore does not have a sufficient inventory system. A physical inventory of items valued at retail price is performed at year's end. A formula is then used to estimate what the ending inventory should be. Finally, a reconciliation is performed of the two, at which time inventory and costs of goods sold are adjusted accordingly. This modified inventory tracking process does not accurately reflect within the general ledger write offs or losses. At the end of the 2003 fiscal year, cost of goods sold and inventory were adjusted to reduce net profit by \$36,177, and inventory of \$135,792 was recorded in the general ledger.

Cause of Condition

The Bookstore does not have an inventory system in place. Without an inventory system to track actual beginning and ending inventories, the bookstore cannot assure the public all assets were accounted for. Furthermore, without this information, management cannot determine whether merchandise is missing or if inventory amounts are obsolete.

Effect of Condition

Since the calculation of ending inventory is based on a formula, the actual inventory valuation is unknown. Further, failure to monitor bookstore inventory could result in a misappropriation or other loss of public funds.

Recommendation

We recommend College management establish and follow adequate internal controls and monitoring including but not limited to an inventory system which accurately reflects bookstore inventory and valuation.

College's Response

The College recognizes that, due to dramatic growth, the current inventory system does not meet the requirements for effectively managing an inventory of this volume or accurately reflect losses due to the shrinkage. The College will investigate inventory systems that will track and report inventory in a more timely, detailed, and accurate way. A major concern is that a more formal inventory system with greater tracking and monitoring will result in additional ongoing costs in staffing, hardware, and software support.

Auditor's Remarks

We appreciate the steps the College is taking to resolve this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

Section 35.10.25 of the Office of Financial Management *State Administrative and Accounting Manual* defines agency responsibilities over inventories.

The agency head must designate, in writing, one or more Agency Inventory Officers to be responsible for maintaining and safeguarding the agency's inventories. These responsibilities include:

- Selecting appropriate inventory accounting methods and systems from acceptable alternatives (refer to Subsection 35.10.35 and Section 85.56);
- Defining and documenting the inventory control points;
- Developing and implementing policies and procedures to safeguard, control, and account for inventories;
- Planning, conducting, and reconciling the physical inventory with inventory records;
- Documenting selected inventory valuation methods;
- Documenting physical inventory procedures; and
- Performing other duties necessary to account for and report inventories.

Section 35.10.45 of the Office of Financial Management *State Administrative and Accounting Manual* outlines the acceptable inventory valuation methods.

First-in, First-out (FIFO) – This method allocates costs on the assumption that goods are consumed/sold in the order in which they were acquired. The first goods purchased are assumed to be the first used or sold. Inventory on-hand is assumed to represent the most recent acquisitions.

Last-in – First-out (LIFO) – This method allocates costs on the assumption that the last units acquired are the first units consumed/sold. Inventory on-hand is assumed to come from earlier acquisitions.

Weighted Average (WA) – This method values ending inventory based on the average cost per unit for the period.

Other - An agency may use an inventory valuation method other than those described above as defined in writing by the agency inventory officer.

03-04 The Automotive Department at Spokane Community College does not have internal controls sufficient to protect public resources from abuse, misuse or misappropriation.

Description of Condition

The Automotive Technology Program at Spokane Community College trains students in automotive mechanics and repair. Students repair vehicles owned by the Colleges and personal vehicles owned by faculty, staff and students. The Automotive Department processed approximately \$99,300 in local receipts during fiscal year 2003. During our review of the Department, we identified the following:

Cash Receipting

- The Department had up to three cashiers receipting from the same cash register. The cashiers do not reconcile the register at the end of their shifts; therefore, no accountability could be assigned if losses should occur.
- The Department did not deposit in accordance with District policy. The District follows the State Administrative and Accounting Manual for the deposit of local receipts, which requires a deposit of receipts when the amount is \$500 or more, or at least weekly.
- Deposit overages/shortages were not properly documented or monitored. We noted instances in which overages/shortages were not recorded by the Department, as manually prepared receipts/invoices were not reconciled to the cash register transactions.
- The Department did not account for the numeric sequence of the manual, pre-numbered receipts. During our cash count we noted that some receipts were not accounted for, which caused an overage and shortages in the deposits reviewed. Also, unless receipt sequence is accounted for, losses could occur and not be detected.

Billing and Write-Offs

- The Department had increased its charge over purchase price from 12 percent to 30 percent without gaining approval from College administration or the District office.
- We noted two instances in which a faculty member and student did not pay the full amount due for parts and tools that were removed from the Department. The faculty member is no longer employed by the College and the student has graduated. The unpaid balances were not reported to the District office to ensure collection procedures occurred, in accordance with District policy.
- The Department closed an unpaid work order on a finished project and released the repaired vehicle to the customer without full payment. The unpaid balance was not reported to the District office for proper collection procedures and/or write-off, in accordance with District policy.

Special Privileges

- Faculty in the Department paid for parts and tools at cost when all students and other faculty and staff were required to pay a 30 percent mark-up. Department faculty used their positions to secure special privileges or exemptions in violation of state law. The Department did not maintain records in a manner that differentiated these two types of transactions so we were unable to quantify the amount of this violation. Pursuant to RCW 42.40.040(1), we are referring this matter to the state Executive Ethics Board.

Payroll/Personnel

- The Department was provided services by a volunteer employee without the approval of the Colleges' District office. Departments are required to report all volunteer employees to the payroll office to ensure proper reporting to the Department of Labor and Industries.

Cause of Condition

The conditions are primarily a result of staffing turnover, staff limitations, insufficient training, and inadequate oversight and monitoring by the College and District management. Also, the Department was not aware of some state laws and regulations, and District policies and procedures.

Effect of Condition

The conditions described above create the potential for Department resources to be missused, misappropriated or lost without timely detection. Noncompliance with state ethics laws could result in disciplinary action by the Ethics Board.

Recommendations

We recommend the Department:

- Ensure each cashier has an individual cash drawer or reconciles the communal drawer at the end of each shift to ensure accountability.
- Perform a comparison to account for the sequence of manual receipt numbers and reconcile them to the register receipts.
- Comply with District policies and procedures related to timely deposits of local receipts.
- Monitor and document the circumstances surrounding deposit overages and shortages.
- Gain approval from the District office for all changes to the billing/fee structure.
- Report collection and write-off issues to the District office for resolution in accordance with District policy.
- Comply with state ethics laws.
- Report all volunteers to the District office.

District's Response

We concur with the auditor's recommendations regarding the internal controls in the Spokane Community College Automotive Department. We acknowledge that the cause for the condition is staff turnover and lack of consistent oversight by the College and District administration. Prompt attention has been taken to ensure the auditor's recommendations are implemented and to ensure that the policies and procedures in effect will sufficiently protect public resources. The District does not believe the Department faculty knowingly used their positions to secure special privileges or exemptions in violation of the state ethics law. However, when this issue was brought to our attention, new procedures were immediately implemented to ensure all sales are made in accordance with an approved pricing plan.

Community Colleges of Spokane will provide a corrective action plan to the Washington State Office of Financial Management that will include specific strategies to address the auditor's recommendations and to improve the internal controls in the Automotive Department at Spokane Community College. We appreciate having these issues brought to our attention and the assistance provided by the Auditor's office.

Auditor's Remarks

We appreciate the District's prompt response and commitment to resolve this finding and thank the District for its cooperation and assistance during the audit. We will review the District's implementation of the planned corrective action during our next audit.

Applicable Laws and Regulations

RCW 42.52.070 related to special privileges states:

Except as required to perform duties within the scope of employment, no state officer or state employee may use his or her position to secure special privileges or exemptions for himself or herself, or his or her spouse, child, parents, or other persons

SAAM 85.50.20 related to deposits of local receipts states:

Cash receipts for deposit in local accounts established pursuant to RCW 43.88.195 or other statutory provision are to be deposited intact within 24 hours of unless:

- A specific written waiver is granted by OFM, or
- Total cash receipts on hand (exclusive of change accounts) are under \$500. However regardless of the amount on hand, local account receipts are to be deposited weekly.

SAAM 85.20.10.a related to receipt format and use states in part:

Use - Collections made over the counter or in the field are to be documented by issuance of an official receipt or through cash registers or automated cashiering systems. Receipts are to be issued in numeric sequence and the numeric sequence is to be strictly controlled. . . .

District Policy 5.10.01 – Accounts Receivable, Procedure 082.20.001, Part 2.1 states:

Community Colleges of Spokane will establish adequate controls, audit trails, and prompt recording, collection and follow-up and remedy of accounts receivable. In accordance with this procedure, state laws and state policies, CCS entities providing goods or services without prepayment are required to follow these procedures. The basic processes of accounts receivable include creating/recording the transaction, producing an invoice, receiving payment, aging receivable balances, collections and write-offs.

03-05 Skagit Valley Community College does not have adequate controls and monitoring over revenues in several departments.

Description of Condition

We noted inadequate controls and monitoring over revenues in the following areas:

- **Radio Station (KSVR):** On-air acknowledgments are given to local businesses that contribute funds to the radio station. This is referred to as underwriting. The College recorded \$7,106 in underwriting revenues during the 2002-2003 fiscal year. The College did not establish sufficient controls over these revenues and as a result a College employee deposited College funds into a personal account. This was discovered when the College attempted to reconcile underwriting contracts to underwriting revenues. The College initially determined \$500 was not deposited with the College and notified the State Auditor's Office as required by state law. The employee repaid the College in this amount. Further investigation by our Office identified at least \$2,328 in additional misappropriated funds between November 2001 and October 2003 by the radio station employee. The results of this investigation have not been finalized.

This loss is not covered by the College's insurance bonding policy because the amount is less than the deductible provision of the policy.

- **Parking:** During the 2002-2003 fiscal year, the College collected \$56,905 in parking pass and parking ticket revenues. The College does not reconcile parking passes issued to revenues received. In addition, the College does not monitor parking tickets issued to ensure it receives all revenues due it.
- **Baseball Auction:** We reviewed cash handling and controls as related to a fund-raising auction for the baseball program. We noted the following:
 - Tickets to the auction were \$20; however, pre-numbered tickets were not used and in some instances, tickets were given away.
 - Revenues collected were not reconciled to actual sales at the end of the event.
 - Preprinted, pre-numbered receipts were not used for auction items sold.
 - Checks were not restrictively endorsed upon receipt.
- **Mailroom:** Some departments within the College receive mail that may contain revenue; however, controls have not been established over mail, increasing the risk that funds could be misappropriated. In addition, we noted multiple times in which the mailroom was left unattended; thus, mail that may have contained revenue was not adequately safeguarded.
- **Transfers of Funds:** We noted several areas in which funds were not verified or safeguarded when transferred between two people. This increases the risk that funds could be misappropriated without fixing responsibility for the loss to a single individual.

Cause of Condition

The College has not established a cash handling policy that addresses controls over revenues generated and/or receipted by decentralized operations and does not provide adequate training to employees who will be receipting cash. In addition, the College has not established an effective system of monitoring over revenues generated by decentralized operations.

Effect of Condition

Inadequate controls and monitoring over revenues led to a misappropriation at the College. This condition also creates an environment that increases the further risk that public funds could be misused, misappropriated or lost.

Recommendations

We recommend the College adopt a cash-handling policy to address controls over all public funds and provide adequate training to employees who will be receipting cash. In addition, we recommend the College establish a system of adequate monitoring over all revenues generated by the College.

We also recommend the College seek recovery of the misappropriated \$2,328 and related audit/investigation costs of \$3,722 from the former radio station employee. Any compromise or settlement of this claim must be approved in writing by the Attorney General and the State Auditor as directed in state law (RCW 43.09.310).

We refer the matter to the Skagit County Prosecuting Attorney for any action deemed appropriate.

College's Response

Radio Station (KSVR): *The College has taken corrective action by implementing additional internal controls that ensure all underwriting receipts of KSVR are properly received, recorded, and reconciled.*

Parking: *The College will increase internal controls and monitoring of parking receipts by performing parking ticket and parking permit revenue reconciliations.*

Baseball Auction: *The College will review all future fund raising events to ensure proper cash handling and controls are implemented.*

Mailroom: *The College will review current mail receipt procedures and ensure that they are centrally received and properly opened and accounted.*

Transfers of Funds: *The College will review this process and implement appropriate corrective changes.*

Auditor's Remarks

We appreciate the steps the College is taking to resolve this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

The Office of Financial Management (OFM) *State Administrative and Accounting Manual* (SAAM), Section 20.20.20 outlines basic internal control requirements:

- Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.
- An internal control system should provide *reasonable assurance* that an organization will accomplish its objectives. The concept of reasonable assurance recognizes that the cost of an internal control activity should not exceed the benefit derived therefrom. Reasonable assurance equates to a satisfactory level of confidence given considerations of costs, benefits, and risks.
- Agency management must identify and analyze the risks to achieving entity objectives and then determine how those risks should be managed. Management defines the level of risk that the organization is willing to accept and strives to maintain risks within those levels.
- Each agency is to adopt methods to assess risk and review control activities. The methods developed should address the specific needs of the agency.

The Office of Financial Management (OFM) *State Administrative and Accounting Manual* (SAAM), Section 20.20.70 describes control activities to help manage risk of loss of funds:

- **Physical controls** - Equipment, inventories, securities, cash and other assets should be secured physically, and periodically counted and compared with amounts shown on control records.
- **Segregation of duties** - Duties are divided, or segregated, among different people to reduce the risk of error or inappropriate actions. For example, responsibilities for authorizing transactions, recording them, and handling the related assets should be separated.
- **Performance indicators** - Certain operating results can be anticipated. By investigating unexpected results or unusual trends, circumstances that jeopardize the achievement of objectives can be identified.

03-06 Western Washington University did not have adequate controls and monitoring over cash receipting, contracts and accounts receivable at two departments.

Background

The majority of cash received by the University is for tuition and fees and comes directly to the central University Cashier. Western Washington University has over 35 departments that accept payments. After accepting payments, each department deposits payments received with the University Cashier. Three of these departments, University Residences, Extended Programs, and the Registrar, function as satellite cashiers and enter receipts directly to the University's cashiering system. The remaining departments bring summarized information to the University Cashier for receipt and recording to the University's central accounting system.

Description of Condition

During the audit period, control weaknesses in cash receipting, billing, receivables, revenue contracts and/or collection procedures were identified in two departments: Communication Sciences and Disorders, and the Athletics Department.

Communication Sciences and Disorders Department

The Department, which annually collects approximately \$115,000 in revenue, did not follow the State Administrative and Accounting Manual or University policies for accounts receivable. Account write-offs totaling \$110,135 were made to client accounts over the prior three years. These write-offs were conducted without management review and approval. In addition to improper account write-offs we found:

- Written procedures addressing collections, uncollectible accounts, and adjustments are not in place.
- Payments and receivables are recorded in two separate software systems, which are not reconciled to each other.
- Inadequate billing practices resulted in the untimely processing of claims, incomplete billings and overdue accounts not being re-billed or reviewed by management.
- Funds are not deposited within 24 hours as required by state law.

Athletic Department

For the period audited, the Department collected \$782,995 in revenue from athletic events, sports camps, sponsorships and marketing agreements.

The Athletic Department had more than 45 contracts and marketing agreements with business organizations. These contracts provided direct advertising and sponsorship revenue to the Department as well as trades for food and beverages at local restaurants. During the prior two years, the Department failed to collect more than \$11,000 due to it from two contracts. The

Department also received non-cash compensation in the form of food and beverage credit at local restaurants. The Department cannot ensure those public assets were used for allowable purposes and/or safeguarded from misappropriation.

The Department lacked adequate monitoring of sports camps revenues due to inadequate management oversight and monitoring for funds deposited, and a lack of accountability as monies are transferred between personnel.

Cause of Condition

The University did not establish sufficient internal controls over account receivables, billings and cash receipting. The University also did not provide adequate oversight and monitoring over contracts and revenues.

Effect of Condition

The absence of adequate internal controls and monitoring contributed to the control weaknesses noted during this audit and increase the risk that public funds could be misappropriated or lost without detection in a timely manner, if at all.

Recommendations

We recommend the two departments, Communication Sciences and Disorders, and Athletics, establish and follow improved internal controls over cash receipting, billings, and accounts receivable, including improved management oversight and monitoring of Athletics revenue contracts and sports camp revenues.

We further recommend the University review and strengthen existing policies and procedures over cash receipting, billings and accounts receivable, and review department activities to confirm that all departments are in compliance with State law and University policy and procedures.

University's Response

Relating to Communication Sciences and Disorders, the State Auditor identified \$110,135 as written off as uncollectible over the prior three years. This amount includes approximately \$20,000 in contractual discounting which are standard discounts for the industry. It also reflects five years of write-offs, as no write-offs occurred during FY 2000 and FY 2001. Nevertheless the University agrees that the total written off as truly uncollectible is occurring at a rate that is higher than acceptable.

The following actions will be taken to strengthen the controls over the billing practices:

- *Management review and approval of accounts to be written off will be documented.*
- *Written procedures will be established to address collections, uncollectible accounts and adjustments.*

- *The two software systems, Medisoft, which interfaces with the clinic's medical records, and SCT Banner, which interfaces with the University's general ledger, will be reviewed to determine which will be the official record of these receivables and how to interface and reconcile the medical records with the University's general ledger.*
- *Billing Statements were mailed in January, 2004, and procedures are being developed to ensure regular billing continues. The clinic has discontinued direct billings for Medicare, and will ensure that all remaining bills are completed accurately and timely.*
- *Procedures are under review to ensure timely deposit of revenues.*

The Athletics Department was audited in 1999 and 2000 and had implemented the suggestions to correct weaknesses observed at that time. The Department is addressing the specific areas identified in this audit finding by:

- *Of the \$11,500 identified as past due receivables, one vendor had signed an agreement to complete payment of \$11,000 by April 25, the other vendor paid their remaining \$500. Future bills will be recorded through the University's General Receivables.*
- *Documentation will be required to support allowable use of services through a trade agreement. It will be retained in the Athletics Department.*
- *Management has been auditing all revenues at sports camps, including verification of meal records. The auditors had selected the Football Sports Camp for audit, and did not find any revenues were missing. An additional spreadsheet will be created as requested by the auditor.*
- *Sports camp registrars and cashiers will count and sign for cash at each cashiering station.*

In addition to the actions which have been taken within the two departments with identified weaknesses, the State Auditor recommends the University consider whether other departments might also have weaknesses within their internal controls over revenues.

The University is in the process of hiring an Internal Control Officer. The first priority of this position will be to review the revenue cycle, to complete documentation, and assist in developing procedures. This will include department training.

Auditor's Remarks

We appreciate the steps the University is taking to resolve this issue. We will review the condition during our next audit.

Applicable Laws and Regulations

RCW 43.09.200 Local government accounting-Uniform system of accounting states in part:

The state auditor shall formulate, prescribe, and install a system of accounting and reporting for all local governments, which shall be uniform for every public institution, and every public office, and every public account of the same class. The system shall exhibit true accounts and detailed statements of funds collected, received, and expended for account of the public for any purpose whatever, and by all public officers, employees, or other persons. The accounts shall show the receipt, use, and disposition of all public property, and the income, if any, derived there from; all sources of public income, and the amounts due and received from each source; all receipts, vouchers, and other documents kept, or required to be kept, necessary to isolate and prove that validity of every transaction; all statements and reports made or required to be made, for the internal administration of the office to which they pertain; and all reports published or required to be published, for the information of the people regarding any and all details of the financial administration of public affairs.

RCW 43.09.240 RCW 43.09.240 Local government accounting - Deposit of collections states in part:

Every public officer and employee, whose duty it is to collect or receive payments due or for the use of the public shall deposit such moneys collected or received by him or her with the treasurer of the local government once every twenty-four consecutive hours...

SAAM 85.44.50b

Written procedures are to be developed and followed to ensure that past due receivables are followed up promptly and in a manner that is cost-effective for the overall collection program. These procedures are to provide for the full range of collection procedures to be used as appropriate, including issuance of statements and dunning letters, phone and personal interviews, filing of suits and liens, referral to private collection agencies or letter services, etc. Agencies that do not have special statutory collection authority, or specialized collection operations are encouraged to use collection agencies after receivables become 90 days past due.

SAAM 85.44.55a

The allowance method of accounting for uncollectible receivables is to be used by agencies.

SAAM 85.44.55d

Prior to or promptly after the write-off of uncollectible receivables occurs; the write-off is subject to management review using procedures developed by the agency in cooperation with the Office of the Attorney General. These procedures

may call for the Attorney General's review of certain types of receivables to ensure that no cost-effective legal means of collecting the receivables remain. After management review, any account determined to have been inappropriately written off is to be returned to the accounting records by reversing the write-off entries.

03-07 Lake Washington Technical College Dental Clinic and Childcare Center cash receipting controls are inadequate.

Background

The College operates a Dental Clinic that provides dental cleaning and restorative care to College students and the general public. Clinic revenues are generated by fees for services that are billed to patients and third party providers. Revenues are recorded in the Clinic's stand-alone computer system. Daily receipts are then deposited at the College Main Cashiering area, where amounts collected are recorded in the Financial Management System. The Dental Clinic collected \$332,280 during fiscal year 2002 and \$329,443 during fiscal year 2003.

The College operates a Childcare Center that provides services to College students and staff, and to the general public depending on available capacity. Childcare registrations are tracked in a stand-alone database. Billings are recorded in the financial system by the Accounting Technician. Amounts are billed quarterly, but payments should be received monthly. The Childcare Center collected \$276,331 and \$245,639 during fiscal years 2002 and 2003, respectively.

Description of Condition

Our review of cash receipting procedures at the Dental Clinic revealed the following control weaknesses:

- The Dental Clinic Program Manager is responsible for billing of services, collection of payments, recording dental receipts into the Clinic's cash receipting system, balancing daily receipts to the Clinic's stand-alone accounting system, preparing the daily deposit and depositing receipts with Main Cashiering. No person independent of the cash receipting process is monitoring the revenue stream to ensure revenues are complete and reasonable.
- Although accounts receivable balances are recorded in the College's general ledger and the total amount owed is reviewed by the Fiscal Tech, detail subsidiary records are only recorded in the Clinic's cash receipting system. No person independent of the billing and collection function reviews the detail accounts receivable records.
- Dental Clinic revenues, per the Clinic's cash receipting system, are not reconciled to the College's accounting system. Our review of Dental Clinic deposits revealed one instance in which a clinic deposit totaling \$1,087 had been credited to the Bakery, rather than the Dental Clinic. Clinic management was not aware the deposit had been improperly posted because there is no reconciliation process between Clinic cash receipt records and FMS.
- The Dental Clinic Program Manager adjusts patient accounts without oversight by a person independent of the cash receipting process. We noted for two out of twelve transactions tested that the Program Coordinator had adjusted a patient's account without obtaining independent approval.

Our review of cash receipting procedures at the Childcare Center revealed the following control weakness:

- The Childcare Accounting Technician is responsible for preparing Childcare billings, monitoring amounts collected and updating receivable information. The Childcare Accounting Technician collects payments by check at the Childcare Center. Cash payments are to be deposited with Main Cashiering by the parent.

Cause of Condition

College management has not had adequate staffing to review Dental Clinic and Childcare Center revenue collection processes and implement controls over revenue collections.

Effect of Condition

Failure to establish controls over decentralized cash receipting locations could result in a misappropriation of funds that is not detected in a timely manner. Our surprise cash count at the Clinic revealed the starting change fund was short \$200. Program staff believes the fund was reduced sometime in 1999. However, no documentation exists supporting their statements.

Recommendations

We recommend College management segregate cash receipting and billing functions within the Dental Clinic and Childcare Center. Furthermore, Dental Clinic revenues posted to the Clinics stand-alone system should be reconciled to official College accounting records.

College's Response

We acknowledge the work performed by the State Auditor's office and respect the recommendations that have been given regarding this issue.

We accept the facts that have been presented and acknowledge that we have internal control processes that need to be tightened.

The ability to fully implement segregated cash and billing functions has been hampered by tight budgetary controls and dwindling state resources. Layoffs and reductions, coupled with unprecedented demand for the college's workforce training programs, resulted in staff shortages. The college also has struggled to limit the losses associated with providing live training instructional activities for dental and child care students. As a result of these challenges, every unit at the college has been required to do more with less and unfortunately this has limited the ability of the college staff to perform procedures using the best practice approach for controls.

We plan to thoroughly review these issues and will reallocate the necessary resources to assist in creating a corrective action plan to improve our controls. The college has curtailed some of its offerings and will thereby reduce a portion of its unfunded over-enrollment to reallocate the needed resources.

We are committed to insuring that the issues and recommendations detailed by the State Auditor's office are addressed and that the college's cash receipting controls are improved.

Auditor's Response

We appreciate the College's response. We will review the College's corrective actions during the next regularly scheduled audit.

Applicable Laws and Regulations

State Administrative & Accounting Manual (SAAM) 20.20.20 requires agencies to establish and maintain effective systems of internal control:

- a. Each agency director is responsible for establishing and maintaining an effective system of internal control throughout the agency.
- b. An internal control system should provide reasonable assurance that an organization will accomplish its objectives. The concept of reasonable assurance recognizes that the cost of an internal control activity should not exceed the benefit derived therefrom. Reasonable assurance equates to a satisfactory level of confidence given considerations of costs, benefits, and risks.
- c. Agency management must identify and analyze the risks to achieving entity objectives and then determine how those risks should be managed. Management defines the level of risk that the organization is willing to accept and strives to maintain risks within those levels.
- d. Each agency is to adopt methods to assess risk and review control activities. The methods developed should address the specific needs of the agency.

03-08 Revenue from the University of Washington School of Dentistry Faculty Practice Plan is not reflected in official University and state accounting records.

Description of Condition

Some School of Dentistry faculty members provide dental care to the public. These services are provided through the School's Faculty Practice Plan. The Plan collects fees for services provided, and a percentage of the net profits are used to compensate faculty members for their clinical services.

We noted in our review that as of June 30, 2003, the Plan had an accumulated cash and investment balance of \$2,969,288 and outstanding receivables of \$2,659,821 resulting from dental services provided by faculty. Neither these amounts, nor expenditures related to the provision of dental services, were reflected in official University and state accounting records.

Cause of Condition

Due to the complexities of establishing and administering a new Plan, coupled with changes in senior School administrators, the assets of the Plan were not recorded in official University records.

Effect of Condition

There is an increased risk that University assets may be misappropriated, misused, or mismanaged without the knowledge of University administration. In addition, the omission of these assets results in an immaterial misstatement of University and state financial statements.

Recommendations

We recommend the School of Dentistry account for the assets and financial activity from the provision of dental services by its faculty under the existing Plan within official University accounting records.

University's Response

We agree that the School of Dentistry's current Faculty Practice Plan activity and assets should be recorded in the University's accounting records and included in its financial statements. We have started to address the communication, compensation and contractual issues that must precede this change.

Auditor's Remarks

We appreciate the University's response. We will review the University's corrective actions during the next regularly scheduled audit.

Applicable Laws and Regulations

State Administrative and Accounting Manual, Section 80.30.05, requires adherence to generally accepted accounting principles:

“The basic principles governing the accounting and reporting activities of the state are required by RCW 43.88.037 to be in conformance with generally accepted accounting principles (GAAP).

The significant accounting and reporting policies of the state of Washington are in conformance with generally accepted accounting principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).”

State Administrative and Accounting Manual, Section 80.20.40a, defines Financial Reporting Requirements to include interim reports:

“In order to facilitate management control, legislative oversight or other purposes, appropriate interim financial statements and reports of financial position, operating results and other pertinent information should be prepared.”

State Administrative and Accounting Manual, Section 80.20.40b, defines Financial Reporting Requirements to include annual reports:

“A comprehensive annual financial report (CAFR) should be prepared covering all activities of the primary government and providing an overview of its discretely presented component units.

State Administrative and Accounting Manual, Section 80.20.45 paragraph 3, defines the reporting entity, to include:

“Other stand-alone organizations (including special purpose governments, joint ventures, jointly governed organizations, and pools) for which the nature and significance of their relationship with the primary government is such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.”

Purchasing and Contracting

03-09 Skagit Valley Community College did not comply with state competitive bid laws.

Description of Condition

In our review of the Culinary Arts Department, we noted competitive bids or quotes were not obtained for the following purchases:

<u>Service Provided</u>	<u>Total Paid in Fiscal Year 2003</u>
Various food products	\$94,959
Dairy products	\$18,377
Coffee products	\$ 9,981
Produce	\$ 4,378

Cause of Condition

The Culinary Arts Director thought the Department was not subject to competitive bid laws.

Effect of Condition

The College cannot assure the public that it received the best price for products purchased from these vendors. Additionally, qualifying vendors that may have wished to bid on the contracts were not given the opportunity to do so.

Recommendations

We recommend the College comply with competitive bid laws. We further recommend the College establish a system of monitoring to identify purchases that are subject to competitive bidding requirements. In addition, we recommend the College communicate competitive bidding requirements to all employees involved in purchasing.

College's Response

The College will implement applicable controls to ensure that competitive bidding requirements are adhered to and that all supporting documentation is retained for all College acquisitions.

Auditor's Response

We appreciate the College's response. We will review the College's corrective actions during the next regularly scheduled audit.

Applicable Laws and Regulations

RCW 43.19.1906 states:

Insofar as practicable, all purchases...shall be based on competitive bids, and a formal sealed bid procedure shall be used as standard procedure for all purchases...This requirement also applies to purchases and contracts for purchases...executed by agencies, including educational institutions.

RCW 43.19.1906(8) provides an exception to the formal sealed bid procedure:

Purchases by institutions of higher education not exceeding thirty-five thousand dollars: PROVIDED, That for purchases between three thousand dollars and thirty-five thousand dollars quotations shall be secured from at least three vendors to assure establishment of a competitive price and may be obtained by telephone or written quotations, or both. For purchases between three thousand dollars and thirty-five thousand dollars, each institution of higher education shall invite at least one quotation each from a certified minority and a certified women-owned vendor who shall otherwise qualify to perform such work. A record of competition for all such purchases made from three thousand to thirty-five thousand dollars shall be documented for audit purposes.

Federal Compliance

03-10 The University of Washington did not comply with federal cost principles for its research and development programs.

Description of Condition

The University of Washington has approximately 470 organizational units that receive federal assistance for research and development programs. Federal grants are audited in accordance with federal standards that require questioned costs in excess of \$10,000 be reported. In the course of our audit of 14 of these organizational units, we noted exceptions in two, totaling \$35,976.59, as documented below:

Cause of Condition

Parenting Clinic

The Parenting Clinic provides programs designed to enhance children's social skills and to reduce behavior problems. It is housed in a rented space off campus. Two inter-related federal grants that total approximately \$10 million pay for the programs. One grant funds evaluation of the Clinic's parent, teacher, and child training and intervention programs in Head Start centers. The other grant funds evaluation of the same programs in kindergarten and first grade. This is the third year of a five-year project.

We noted the following regarding costs charged to these two federal grants:

- Rent was allocated entirely to one grant for a year and entirely to the other grant for another year, with the expectation that costs would be shared equally between the two grants over the life of the projects. However, we determined that costs should have been split 56 percent to 44 percent based on use of the space.
- Due to a coding error, use tax and indirect costs were improperly assessed against the grant for school-aged children.
- Telephone costs (telephone lines, telephones, etc.) were inaccurately distributed to the two grants.
- Grant programs shared supplies and materials. Because of the interrelationship of the grants, it was not possible to account for actual usage of these materials by grant. The Clinic charged all duplication costs to the grant for school-aged children until March 2003, when it began charging them to the grant for Head Start centers. The costs of other supplies and materials were allocated substantially proportionate to the level of funding provided by each grant. We determined costs should have been distributed 63 percent to 37 percent based on enrollments in the programs.

- Gift cards were used to compensate families for participation in the research programs. However, an inventory of these gift cards was not maintained by grant. The cost of gift cards was allocated almost equally between the two grants without regard to actual usage.

Applied Physics Lab

The Applied Physics Lab is the largest single recipient of federal assistance within the University, having received approximately \$41 million in the past year. It conducts basic and applied research, development, engineering and education for science, industry and national defense.

One project, the 2003 Ice Camp, supported Navy test operations and work by civilian scientists monitoring changes in the Arctic. Overtime worked by University employees engaged in this project was communicated to the Payroll Coordinator in an e-mail from the Research Coordinator. Due to a miscommunication between these two individuals regarding the calculation and reporting of overtime, and the lack of any detail in the e-mail as to the number of overtime hours worked each day, two employees were overpaid a total of \$5,020.55.

Effect of Condition

These conditions resulted in \$28,431.36 of questioned costs charged to CFDA #93.361, \$6,791.75 of questioned costs charged to CFDA #12.000, Contract # N00024-02-D-6602/0020 MOD03 and \$753.48 of questioned costs charged to CFDA #93.279.

Subsequent to our audit, the Parenting Clinic established a system to separately track the use of gift cards by grant. The University made appropriate transfers and adjustments to correctly allocate costs and remove unallowable charges from affected grants. It also entered into agreements to recover overtime payments.

Recommendations

We recommend:

- The Parenting Clinic take steps to ensure the accurate allocation of costs to its grants. These steps should include adequate training and guidance for the Clinic's Research Coordinator.
- The Applied Physics Lab revise its procedures to require detail reporting of overtime hours worked by employees.

University's Response

We agree. The Parenting Clinic has developed methods to allocate costs to its grants; administrative review of the distribution will be done quarterly. The budget coordinator for the Clinic is scheduled to attend University-sponsored training and will meet regularly with department administration for guidance on grants management. APL is revising its weekly time sheet forms so that overtime-eligible employees will be required to provide daily detail on any

overtime hours worked. Until the revised time sheet forms are available, APL has implemented an interim reporting procedure to obtain a daily record of overtime hours worked.

Auditor's Remarks

We appreciate the University's response. We will review the University's corrective actions during the next regularly scheduled audit.

Applicable Laws and Regulations

Office of Management and Budget Circular A-21, Section C, which requires costs to be reasonable and allocable to the sponsored agreement, defines allocable costs in subsection 4.a as:

“A cost is allocable to a particular cost objective (i.e., a specific function, project, sponsored agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a sponsored agreement if (1) it is incurred solely to advance the work under the sponsored agreement; (2) it benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods, or (3) it is necessary to the overall operation of the institution and, in light of the principles provided in this Circular, is deemed to be assignable in part to sponsored projects.”

Office of Management and Budget Circular A-21, Section C, subsection 4.d further states:

“(1) *Cost principles*. The recipient institution is responsible for ensuring that costs charged to a sponsored agreement are allowable, allocable, and reasonable under these cost principles.
(2) *Internal controls*. The institution's financial management system shall ensure that no one person has complete control over all aspects of a financial transaction.
(3) *Direct cost allocation principles*. If a cost benefits two or more projects or activities in proportions that can be determined without undue effort or cost, the cost should be allocated to the projects based on the proportional benefit. If a cost benefits two or more projects or activities in proportions that cannot be determined because of the interrelationship of the work involved, then, notwithstanding subsection b, the costs may be allocated or transferred to benefited projects on any reasonable basis, consistent with subsections d.(1) and (2).”

Other State Legal Compliance

03-11 The University of Washington does not have controls sufficient to ensure compliance with state laws for out-of-state bank accounts.

Description of Condition

As of April 2003, the University had established 11 foreign bank accounts to fund research projects and other programs conducted outside the state of Washington. Per state law, such accounts cannot have a balance of more than \$50,000 and must be pre-approved by the Public Deposit Protection Commission. University foreign bank accounts approved by the Public Deposit Protection Commission were authorized for a total of \$272,500.

During the current audit, we found the University does not have sufficient controls to ensure compliance with the law. We noted:

- The University has not verified whether additional funds transmitted for deposit into out-of-state bank accounts will cause these accounts to exceed limits established by the Public Deposit Protection Commission.
- On six occasions, the University transmitted for deposit into out-of-state bank accounts amounts that exceeded authorized limits. In one instance, the officials responsible for ensuring compliance transferred \$60,000 to a foreign account authorized for only \$30,000.
- Four accounts had not been approved by the Public Deposit Protection Commission. The University had advanced \$101,738 for deposit into these accounts. One of the accounts had not been approved because the funds were placed into an out-of-state bank account without the knowledge of University officials responsible for ensuring compliance.
- Two authorized accounts were consolidated into one, with funds on deposit exceeding limits established for any one account.

Cause of Condition

University officials responsible for ensuring compliance stated some research projects are large and they did not wish to hinder their continuance by limiting funds advanced. In addition, bank accounts are difficult to establish in some foreign countries and the recent focus of University officials has been to improve the timely accounting for funds advanced to researchers.

Effect of Condition

The University violated state laws regarding out-of-state bank accounts.

Recommendations

We recommend that the University establish and follow controls to ensure out-of-state bank accounts conform to state law. We further recommend that accounts greater than \$50,000 be decreased to the limits established by law.

University's Response

We agree that the University should establish controls to verify that additional funds transferred to alien bank accounts do not cause these accounts to exceed PDPC-authorized limits. However, we disagree that all funds identified by the State Auditor are subject to this state law and are seeking legal advice from our Assistant Attorney General. We will also be meeting with the PDPC to explore alternatives that will allow the University to conduct its growing international, multisite, educational and research programs without violating state law.

Auditor's Remarks

According to legal advice from our Assistant Attorney General, all University funds are subject to the limitations on out-of-state bank accounts. Therefore, we reaffirm our finding.

We understand that compliance with state law may restrict the University's ability to conduct its growing international educational and research programs. Therefore, we support University efforts to work with the Public Deposit Protection Commission to explore acceptable alternatives that will allow compliance with the law.

We would like to express our appreciation to staff for their assistance and cooperation throughout the audit process.

Applicable Laws and Regulations

Revised Code of Washington 39.58.010 defines public funds as:

“moneys under the control of a treasurer or custodian belonging to, or held for the benefit of, the state or any of its political subdivisions, public corporations, municipal corporations, agencies, courts, boards, commissions, or committees, including moneys held as trustee, agent, or bailee.”

Revised Code of Washington 39.58.080 restricts the establishment of demand accounts outside the state of Washington:

“...no public funds shall be deposited in demand or investment deposits except in a public depository located in this state or as otherwise expressly permitted by statute...”

Revised Code of Washington 39.58.085, describing the powers of the Public Deposit Protection Commission, states in part:

“The commission, or the chair upon delegation by the commission, may authorize state and local governmental entities to establish demand accounts in out-of-state and alien banks in an aggregate amount not to exceed one million dollars. No single governmental entity shall be authorized to hold more than fifty thousand dollars in one demand account.

The governmental entities establishing such demand accounts shall be solely responsible for their proper and prudent management and shall bear total responsibility for any losses incurred by such accounts.”

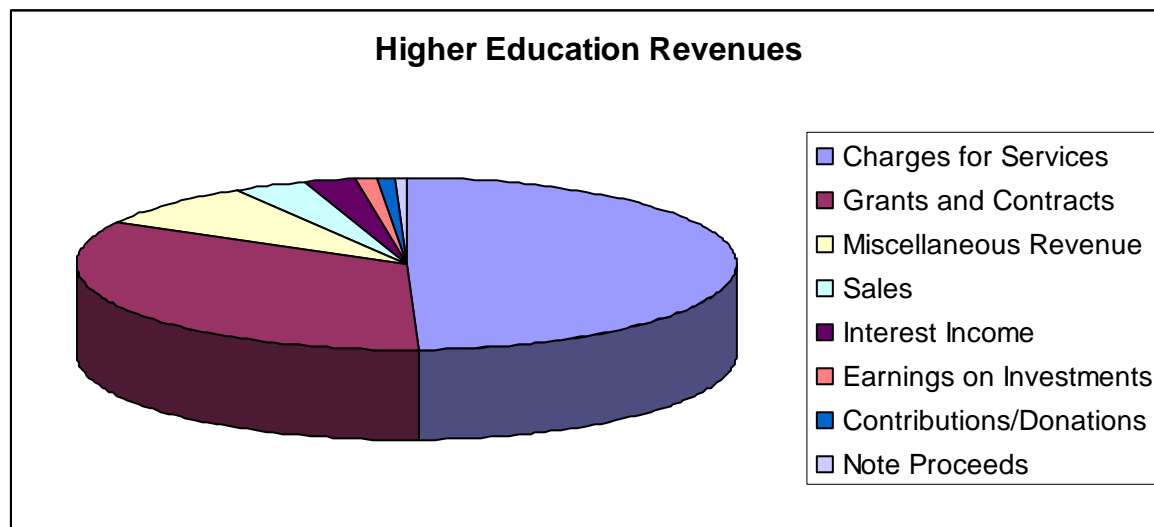
State of Washington Higher Education Statistical Information

The State Auditor's Office uses statistical information in planning our audits of the state of Washington. The analysis may include a review of revenues for unusual or unexpected fluctuations or to identify a new revenue source. Analytical procedures may include a review of expenditures to identify unusual or significant increases in program expenditures or to determine if payments to vendors, providers or contractors could be questionable.

The following provides summary information on the revenues, federal dollars received and expenditures the system incurs.

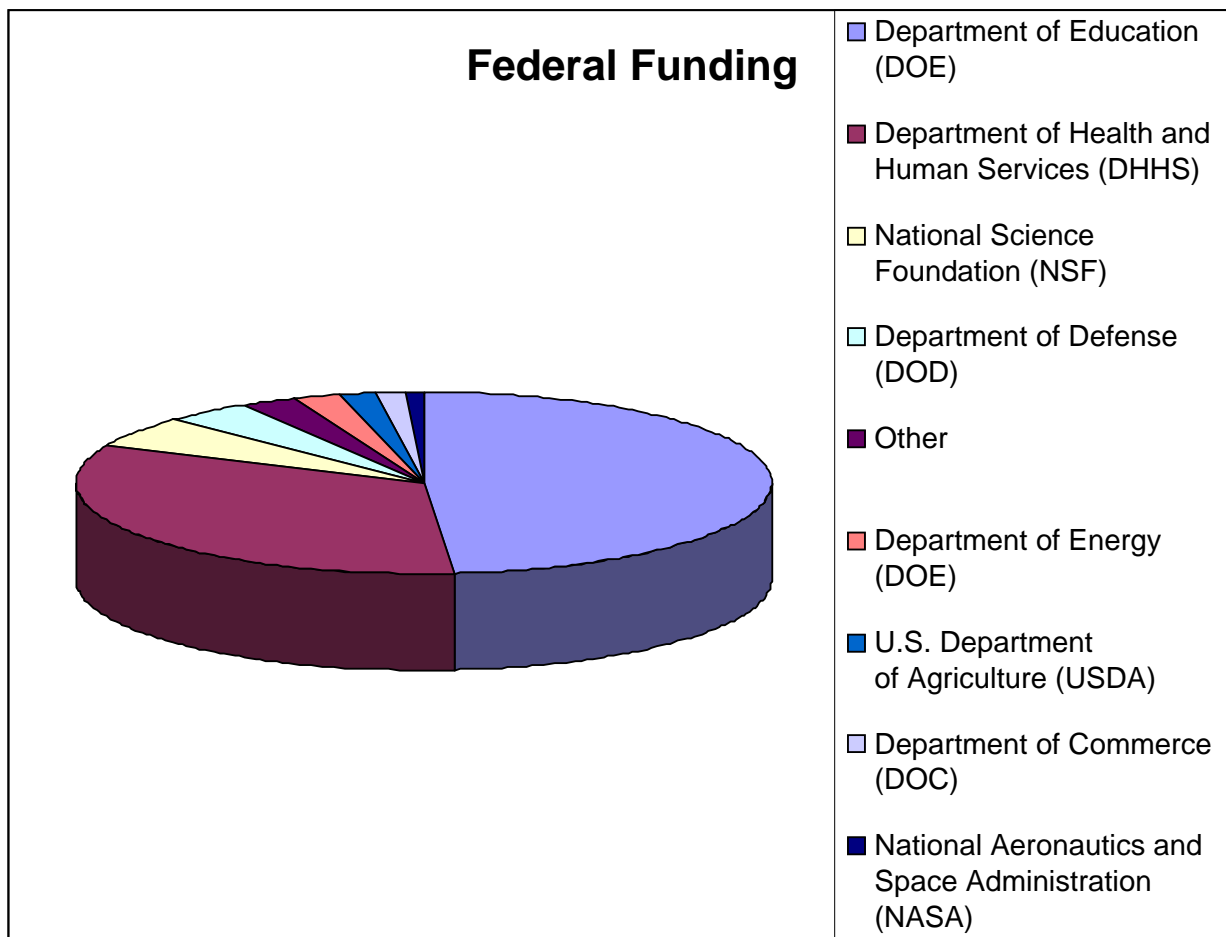
Revenues – The state of Washington's higher education revenue totaled \$4.164 billion for fiscal year 2003. As shown below, those revenues included taxes, charges for services, tuition, federal grants and private contributions. Our approach is to focus on those revenues subject to risk of fraud or noncompliance with state law. We review the internal controls and processes to ensure that the money collected is deposited.

Charges for Services	(\$2,053,922,365.67)
Grants and Contracts	(\$1,403,170,011.07)
Miscellaneous Revenue	(\$345,132,762.71)
Sales	(\$154,921,462.85)
Interest Income	(\$98,386,368.72)
Earnings on Investments	(\$48,062,062.05)
Contributions/Donations	(\$36,095,172.88)
Note Proceeds	(\$24,949,943.11)
	(\$4,164,640,149.06)



Federal Funding – The state of Washington higher education system received \$1.5 billion in federal money in fiscal year 2003.

Federal Agency	Federal Dollars
Department of Education	\$ 747,315,024.00
Department of Health and Human Services (DHHS)	\$ 510,934,348.00
National Science Foundation (NSF)	\$ 86,524,906.00
Department of Defense (DOD)	\$ 62,082,993.00
Other	\$ 39,209,902.00
Department of Energy (DOE)	\$ 32,829,387.00
United States Department of Agriculture (USDA)	\$ 27,505,152.00
Department of Commerce (DOC)	\$ 20,347,903.00
National Aeronautics and Space Administration (NASA)	\$ 13,754,548.00
	\$ 1,540,504,163.00



Expenditures – For the fiscal year, expenditures for higher education totaled \$5.681 billion.

EDUCATION	\$ 3,516,147,808.46
SALARIES, WAGES, AND BENEFITS	\$ 569,631,317.96
CAPITAL OUTLAYS	\$ 499,758,906.32
GOODS AND SERVICES	\$ 468,339,561.94
MISCELLANEOUS	\$ 472,183,966.06
PERSONAL SERVICES	\$ 22,900,719.88
DEBT SERVICE	\$ 22,818,307.75
COST OF GOODS SOLD	\$ 109,785,079.11

\$ 5,681,565,667.48

